RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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November 8, 2000 LETTER 1309

Oct 20, DJIA 10226.82; PTI 5170; A-D Ratio –7.57
Oct. 27, DJIA 10589.88; PTI 5166; A-D Ratio –7.65
Nov. 3, DJIA 10817.95; PTI 5176; A-D Ratio – 6.92
***Dow Yield: 1.66%; *Dow Price/Earnings: 19.4**
***Dow Times Book Value: 6.6**
***Percentage of Undervalued Blue-chips: 17%**
***Gold 34-day MA: 272**

WHERE ARE WE? I'll defer to my Primary Trend Index, because the PTI has proved, over a period of 31 years, that it's smarter than I am.

The PTI turned bullish back in July. It then rallied to a record high of 5226 on August 6. From there it headed down. The PTI turned bearish on October 9 (at 5176) when it broke below its 89-day moving average.

The PTI then sank to a low of 5160 on October 8. Next, it milled around for a few weeks, but on October 31 the PTI decided that it had had enough of the downside.

On October 31 the PTI turned bullish again as it rallied above its moving average again -- at a value of 5178. That last move is not what I expected, but as I admitted above, the PTI is smarter than I am. And if there's one thing I've learned over the years is that you don't fight the PTI.

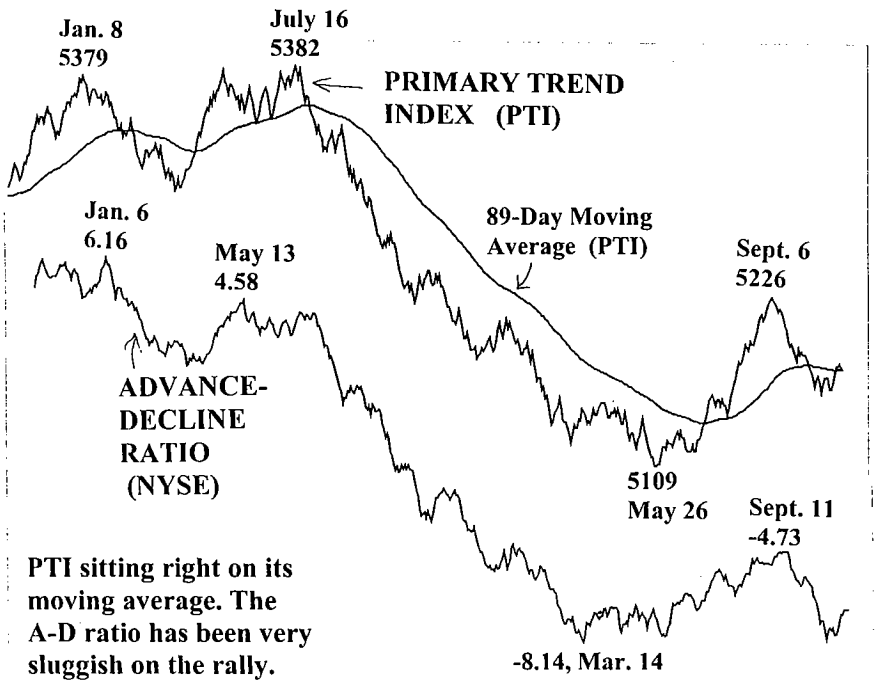
The PTI is my Frankenstein; I invented it but I can't control it. The PTI is the "market monster," and you have your choice of following it or ignoring it – but you never fight it. You don't fight it because it's got the power of the primary trend behind it.

Of course, the question now is whether the PTI, having turned bullish, is going to extend its move to the upside or whether it's going to turn bearish again. I wish I could predict its next move, but I can't. You can't predict the predictor.

THE PICTURE: I've said this before, but I'll repeat it. The Dow has not closed below the low of a preceding year since 1982. That's 18 years of "a higher Dow." No wonder today's investors are "highly confident." No wonder they believe that every decline is a "buying opportunity" that will be followed (in a short time) by a higher market.

The Dow low for the year 1999 was 9120.67. That low, at this writing, appears "safe." But, of course, you never know in a bear market.

Furthermore, we have not even seen a down year in the Dow since 1990, the longest such stretch in stock market history. The Dow closed last year, on December 31, at 11497.12. If the Dow this year closes below that figure it will have done something that it has not done in a decade.



Meanwhile, the hallmark of this primary bear market continues to be **attrition**. Whatever stock you buy, give it time and it will leave you with losses.

Due, probably to thousands of mutual funds which continue to stay fully invested in stocks, this is **a zero-sum market**. The funds don't move to cash as they used to. They stay fully invested and simply move their money around, trying to position themselves in a group that is rising.

Up to recently, the funds were loaded with the "can't miss" tech stocks. And of course the public followed, buying IPOs and tech stocks "hand over fist."

Now with most tech stocks collapsed, the funds are moving into blue chips while the public wonders what to do with their battered and shredded funds. What should they do with them? Don't ask me - I never suggested buying them in the first place (of course, the answer is -- "Get out of them").

I've got a question - what ever happened to the day traders that we used to hear so much about? What happened to them is that they have been "knocked out of the box."

They've been killed by a wildly volatile market, a market that can open down 60 Dow points and end up 120 Dow points. Or a market that can open up 1200 S&P points and close down 1000 S&P points.

How do you trade a market like that? You don't. Because if you do, you'll end up with patched pants and strips of cardboard in your shoes. This is about the toughest market I've ever seen to trade in. Stocks crash overnight, stocks surge in an hour, dear old IBM which was 134 in early-September, broke 90 on October 25. On the same day Nortel gapped down 17 points at the opening and JDSU was down over 16 points.

MOVING AVERAGES: Over the last 45 years I think I've studied most of the available market techniques. As veteran subscribers know, the techniques I give most credence to have to do with **market action.**

Market action doesn't really change much over the years. A guiding principle is this – every movement up or down, whether primary, secondary or minor – **is ultimately corrected.** This is an excellent principle to keep in mind at all times.

One technique that I use to gauge the strength or weakness of an item is based on the juxtaposition of two moving averages. I use a 50-day moving average and a 200-day moving average. Why those two? Because they seem to work.

Examples: Let's say a stock is declining. If the decline is powerful enough and lasts long enough, at some point the shorter 50-day MA will sink below the longer 200-day MA. When that happens, I call it an important show of weakness. If the stock is below its 50-day moving average, I say that the stock is in a "bear mode."

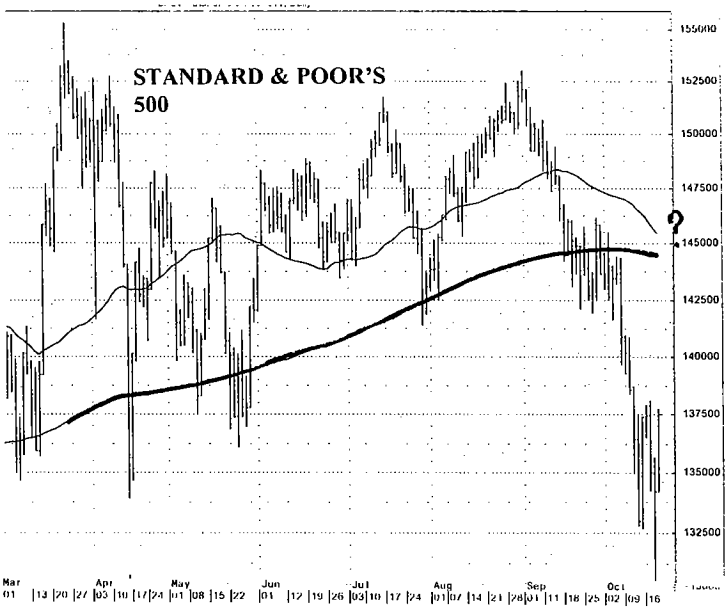
Now let's say that the stock continues down. But at some point, the stock will rally. In most cases, the rallying stock will halt below its 50-day MA, and then turn down again. This is the normal failing rally - failing in that the stock does not have the strength to advance above even the shorter of the two moving averages.

As soon as the item turns down from below the 50-day MA, I call this a "sell spot."

I want to illustrate my moving average studies with a few chart examples.

The first chart (p. 3) shows the S&P Composite on October 19. Bold line shows the 200-day moving average. Here we see the 200-day MA turning down, but the 50-day MA, although declining rapidly, is still above the 200-day MA. I call this a potentially negative situation because although the S&P is well below both MAs, the 50-day is still above the 200-day MA.

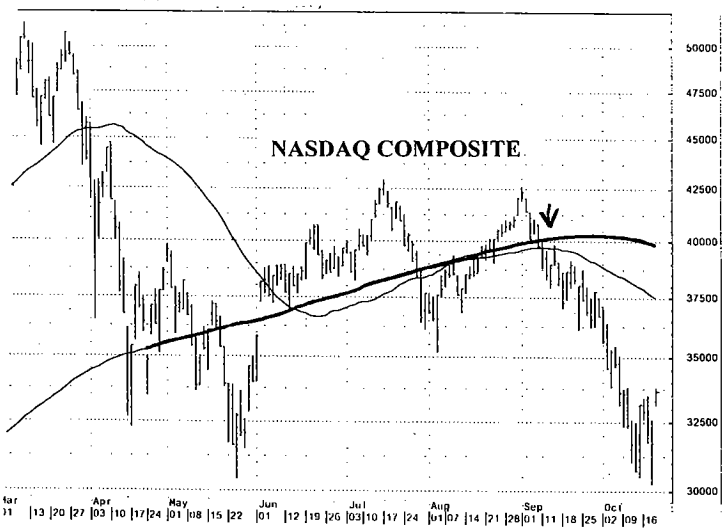
In other words, the decline has not lasted long enough or been powerful enough to take the 50-day below the 200-day. However, it does look as though in a week or so the 50-day MA will break below the 200-day MA. If or when



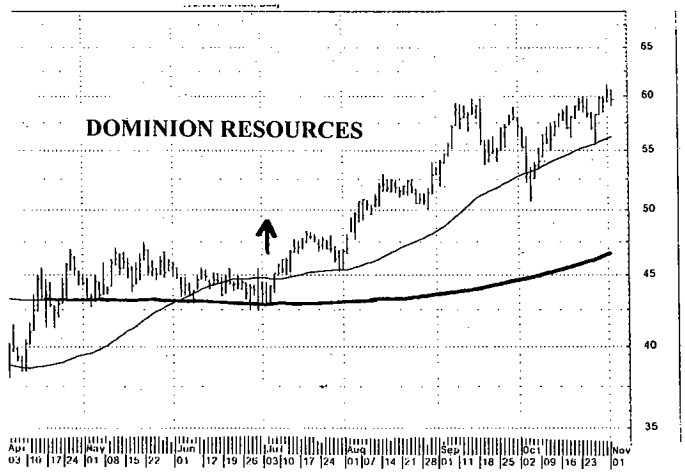
that happens, and if the S&P is still below both MAs, the situation will turn solidly bearish. The 50-day being below the 200-day will put what I call a "technical roof" over the S&P.

Note also how **far** the S&P is below its 200-day MA. This suggests that the S&P is at least semi-oversold and ready to rally. The rally, even if it is powerful, should halt at or near the vicinity of the declining 50-day MA. (note: on October 31 the 50-day MA did fall below the 200-day MA).

The second chart shows the Nasdaq Composite on October 19. Here we see a more advanced bearish situation in that the declining 50-day MA is below the declining 200-day MA and the Nasdaq is below both. Again, note that the Nasdaq is quite far below the 200-day MA, thus allowing for an upside rally. The rally, at best, should halt at or below the 50-day MA.

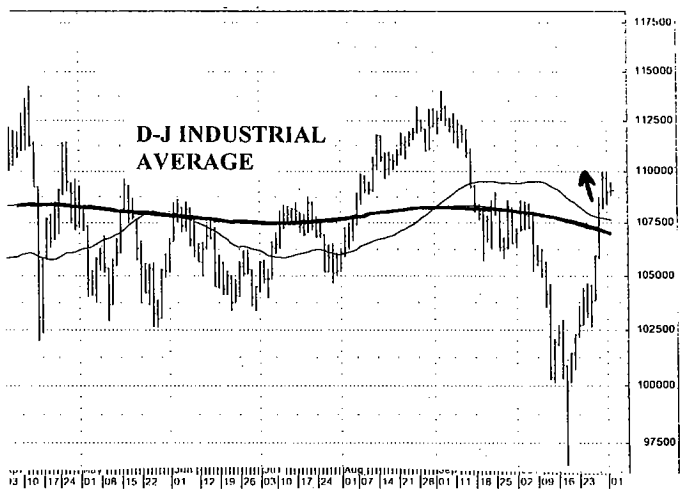


The third chart shows Dominion Resources (D), a stock that I've recommended repeatedly. The 50-day MA crossed above the 20-day MA on June 5. On July 7, D surged above its 50-day MA, and the stock began a long climb. Note how far the 50-day MA is above its 200-day MA. This is very powerful action, and the moving average signals worked very well in this case.



The fourth chart shows the Dow. The Dow plunged to a low on October 18, but note that during that period the 50-day MA continued to hold ABOVE the 200-day MA. I've continued to state that the Dow is the "strongest of the major stock averages." Then on October 30 the Dow pushed above both its 200-day MA and its 50-day MA. This constituted a "bull signal" for the Dow, and that's where the Dow is now – in a bull mode.

To turn bearish, the Dow would have to plunge below both MAs and the decline would have to be powerful enough and last long enough to take the 50-day MA BELOW the 200-day MA. We've seen this action in the S&P and the Nasdaq, but not yet in the Dow.



RISK and REWARD: I wrote about risk on one of my daily Internet sites last week, but since I have a few thousand subscribers who are not on the net, I want to write a bit more about risk.

For some reason, risk is one of the least discussed subjects in investing. Yet it is crucial for investors to understand and be aware of risk and the CONSEQUENCES of assuming a risk that doesn't work out.

The current stock market, by almost all historical measurements, is expensive. I've gone over the figures and measurements a hundred times. I've talked about the fact that the broad S&P sells for 25 times earnings and yields only 1.6%, the fact that the Dow has not broken below a previous year's low in 18 years, the fact that the Dow hasn't had a down year in a decade, about the thesis of regression to the mean. So let me put it succinctly, this market is **expensive,** and this market, on a longer-term basis, is virtually **uncorrected.**

Any way you look at it, this is a high risk market. If you believe otherwise, you're just kidding yourself (and I know that a lot of younger analysts do think differently).

When you buy stocks here you must consider the risk and the consequences of being wrong. What are the consequences of buying stocks in a high risk market?

Well, we're seeing one of the consequences in what I call the "Disaster du Jour." This is the collapse (and I mean COLLAPSE) of one, two or three stocks on a daily basis. Last week I guess the disaster-winner was widely-held WCOM; the stock was 50 in July -- on Wednesday it closed just over 18, having lost almost two-thirds of its value in less than four months.

The list of disasters is long and growing, from MSFT to T, from PG to INTC. These are not just minor, unknown stocks, these are important, widely-held stocks.

Furthermore, we're not seeing insignificant losses in these stocks, we're seeing HUGE losses. For this reason, it's imperative that you consider the risk and consequences of buying stocks in a very expensive market.

Anytime you buy a stock (or anything else for that matter), you have to think of the **consequences if you are wrong.**

Examples: Your broker calls you and tells you that he's excited about a certain stock, and he thinks it's headed for "a double." He wants you to buy 500 shares for $75,000. Your entire net worth is $300,000. You think about it, but decide that the consequences of the stock not doing what your broker said it would -- is too risky. You're talking about risking 25% of your entire value on a single stock. You tell your broker that you'll pass.

The same broker calls your best friend with the same story. Your best friend is a multi-millionaire. He considers the risk and the consequences of the stock being a dog. Your friend ponders the situation: he concludes that if the stock doesn't work out, he can sell it and, at worst, sustain a loss of $20,000. The consequences of a $20,000 loss won't hurt your friend, and he concludes that the speculation is worth a shot. He tells the broker, "OK, let's do it."

The same broker calls a third friend with the same offer. This friend cannot stand stress. He knows his own psyche, and he knows he's only at peace with stable, staid, dividend paying stocks. The consequences of buying the broker's prize stock would be a lot of stress, regardless of whether the stock went up or down. He tells the broker, "It sounds good, but it's not my kind of stock. I've got to sleep nights, but thanks anyway."

Conclusion: Risk, and the consequences of assuming risk are critically important. In any purchase, whether a stock or a home or a car, consider the degree of risk, and the consequences if the risk turns out badly. I consider the consequences, no matter what I buy. And I don't' think I've ever taken a loss that I couldn't handle with a minimum of stress.

INVESTMENT POSITION: The bear stays in the box, even as the averages whip back and forth, buoyed by the huge liquidity but at the same time pressured by the high level of interest rates, rising inflation, and weakening corporate profits.

There are two areas that particularly interest me now. But first let me explain. If the period ahead moves to inflation, then somewhere ahead commodities and hard assets will move up. It may take a while, but when that happens, it will find gold shares "on their backs." For this reason, with Homestake (**HM**) in the low 3s, I think this stock is a decent long-term "forget you own it" holding. At 3 and a fraction, **HM** is priced so low it's like a perpetual warrant. You want the leader? At just over 13 Newmont Mining (**NEM**) looks cheap – and finally there's Franco Nevada (**FN**) (traded in Toronto, but quoted in *WSJ* daily).

There's one absolutely essential asset that can't be substituted or replaced, and it's water. As the population grows, there's an unescapable increasing need for water. I list four private water company stocks that might be worth putting away "for the grandchildren." All offer dividend yields of 3% or more, with one, **AWR**, paying over 4%.

The water stocks are **AWK**, American Water Works, by far the largest private water company; **CWT**, California Water Service; **SWWC**, Southwest Water Co.; **AWR**, American States Water.

I think there's a better than 50/50 chance that the dollar has now topped out. Our negative current account balance continues, and it's unsustainable. You know what the economist said, "If something is unsustainable, it will stop."

With the dollar in the process of topping out, I would not blame anyone for taking their profits in bonds and switching to 91-day T-bills or a tax-free money market fund.

Remember, the only thing that's been keeping our foreign dollar and security holders sitting tight is the high-growth in the US and the high interest rates. If growth slows down, the dollar will come down.

Greenspan has had a picnic so far. The picnic may be very nearly over.

NOTES & QUOTES: An article in the October 17 *LA Times* is entitled, "**Analysts Criticized for Herd Mentality, Laggardly Moves.**" My own "take" on most of the analysts is "what good are they?" The majority and the ones you hear from, work at brokerage houses. Many deal with stocks that have been underwritten by the same brokerage house. But in general, the analysts almost never put an outright "sell" on a stock, which I find both annoying and deceptive.

An example cited by the *LA Times* is Priceline.com. On September 27, 16 of 20 Wall Street analysts considered PCLN either a "buy" or a "strong buy." Then someone warned that weak airline sales would hurt PCLN and the stock started to drop. Today, with the stock down to 6, almost every analyst is bearish on the stock. But where were they at the highs?

In reverse, in the fall of 1999 almost no analyst liked Disney when it was in its 20s. This year DIS suddenly attracted a flock of analysts - but only after the stock had risen more than 50% to over 35. Again, the herd mentality.

Says David Dreman, a former Wall Street analyst: "Say I was a personal-computer analyst, and I made a negative call on the industry. I could lose all of my contacts at the companies and would be unable to do my job." Dreman said it's far safer for an analyst to be wrong but in lots of company, than to be out of step.

* *

Question: would you buy this stock? It has registered steep declines in return on equity and operating margins over the last five years. It has shown no year-over-year growth in adjusted earnings per share during the past 12 months. It has depended more and more on "other income" to fill out its bottom line. What is this stock? It's none other than Cisco (courtesy of *Grant's Interest Rate Observer* (212 809 7994).

* *

An article in the October 23 *Barron's* notes that if Cisco had adhered to less "creative" tax returns, it would have shown a loss for the year.

Despite an official tax rate of 35%, many large corporations pay no taxes. This is due to write-offs for options, depreciation and other tax breaks. In its latest fiscal year, Cisco paid no taxes. The Treasury in '98 gave Texaco a $67.7 million refund, and Pepsi got a refund of $302 million. In '98 Chevron got back $186 million, Colgate got $19.8 million, GM got back $19 million, MCI Worldcom got $112 million, and Phizer got $197 million.

* *

Speaking of taxes, the tax burden on Americans is now the highest ever in peacetime. Federal tax receipts in fiscal 1999 totaled $1.8 trillion or 20% of GDP. During the post-War period, taxes have seldom exceeded 18% of GDP. The only other time in the nation's history that taxes were as high as they are now was during World War II.

This revenue explosion is mainly due to the sharp increase in income taxes paid by individuals. These payments have increased from 7.8% of GDP to the present 9.8% of GDP. This is the highest they have EVER been (statistics courtesy of Amer. Inst. of Economic Research, Great Barrington, Mass. 01230).

* *

Bush and Gore continue to talk about how they're going to spend the giant surpluses that are coming up over the next 10 years. But now people are saying that there may not be any surpluses at all. The biggest reason for the current surpluses are the government's take on income taxes, taxes generated by the bull market, and the boost in taxes on the rich.

* *

If the Dow is below 11497.12 on the last trading day of this year, it will mark the first time since 1990 that the Dow will have had a losing year. The candidates might mull this one over when they talk about how they're going to spend the big surplus. The fact is that revenue expectations for the next ten years are wildly optimistic.

* *

Inflation in housing has been running wild here in La Jolla. According to the La Jolla Real Estate Broker's Association, the average sales price of a house here climbed from $990,000 last year to $1,360,000 this year, a huge 37.3% gain. Today there are 43 homes in La Jolla selling for $1 million or more, 19 homes selling for $2 million plus, nine homes selling for $3 million plus, four for more than $4 million, and 12 at $5 million or more.

So, *Welcome to La Jolla*! When I moved to La Jolla in 1967 I could have bought any house in the town for $100,000. Thanks Fed, you've really kept the purchasing power of the dollar in check.

* *

Speaking of housing, at Barbra Streisand's final concert, before singing her signature song, "People," she asked the

crowd, "Anyone want to buy a Central Park West penthouse? A triplex? I've got one, fifteen rooms. Call Douglas Elliman." The next day her broker got over 500 calls from as far away as Seattle and Germany.

* *

The price of housing and what sold to whom for how much has become a regular item of gossip in New York. The *New York Observer* and *New York* magazine regularly report on high-priced housing sales and just who bought them. Co-ops are going in NYC from a million to ten million and more. And once on the market, they don't last very long.

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Good Times are Still Rolling Dept: According to the United States Personal Chef Association, ten years ago 1,000 families in the US employed personal cooks. Today, states the Association, 100,000 families employ their own chefs.

* *

On the other hand, the *WSJ* (Oct. 20) talks about the new "90 percent club." This is the club that is comprised of dot-com owners who have lost 90% or more of the peak value of their funds. I just spoke to a friend who owns commercial buildings here in San Diego. He said that he will no longer rent space to dot-com companies, even if they are willing to put down the entire first year's rent on a five-year lease. I asked him why. He said that he'd be too worried about the second year – and the third and the fourth and the fifth.

* *

What are the most "wired" cities in the US? The top five are San Franciso 65.5%, Seattle 63.6%, San Diego 61.9%, Portland, Ore. 59.5%, and Washington 59.0%. The bottom five are Hartford/New Haven 52.6%, Sacramento 50.8%, Indianapolis 50.5%, New York 50.3%, and LA 49.9%.

* *

Says Steve Jurvetson, a venture capitalist at Draper Fisher Jurvetson, "One filter we use is – Is this a business that could have existed before the Internet existed? If so, it's probably not worth it."

* *

Is New York the "center of the universe" as many New Yorkers claim? Well, maybe – check these figures out. New York has two baseball teams, it has five buroughs, it has 150 museums, 163 theaters and 18,000 restaurants. It also has Trump, Seinfeld, Madonna, and more celebrities than any other place in the world.

* *

You wonder if there's any inflation? You wonder whether the Fed is protecting the purchasing power of the dollar? The Answer is in this listing below (by the way, the monthly rent statistics have to be wrong):

Soaring staples

The average price of most goods and services rose steadily in San Diego during the 1990s.

Item	1989	1995	2000
Half-gallon milk	$1.14	$1.71	$2.47
Tuna, 6 oz. can	$0.67	$0.90	$1.02
2 liter Coca-Cola	$1.12	$1.18	$1.35
Tire balance	$7.88	$10.18	$8.77
Toothpaste, 6 oz. tube	$2.03	$2.52	$3.12
Quarter pounder	$1.85	$1.99	$2.28
Dozen eggs	$1.81	$1.83	$2.18
Gallon of gas	$1.05	$1.29	$1.84
Corn flakes, 18 oz. box	$1.76	$2.67	$2.75
Beauty salon	$23.20	$23.89	$31.71
Dry cleaning (men's suit)	$5.68	$6.41	$7.06
Monthly apt. rent	$911.00	$899.20	$961.50
Monthly phone bill	$14.73	$15.78	$16.89
Men's jeans	$18.98	$29.22	$32.49
Coffee, 13 oz. can	$2.29	$3.44	$3.56

LATE NOTES: Is the stock market expensive? The Q ratio was invented by James Tobin of Yale University. The Q ratio value compares two different values of stock market – one is what Wall Street says the companies are worth and the other is the companies' "fundamental value" or what it would actually cost to replace their physical and financial assets. Currently Q is now at about 150% of replacement value, or 2 ½ times its average level during the previous century. In contrast, the Q in the late 1920s and in the late 1960s and again in the early 1970s was slightly more than 120%.

Inflation watch: the differential between the 10-year T-note and the inflation-adjusted 10 year T-note (TIPS) has now risen to 1.96%. This is the highest level in months, and it's a level that you can be sure the Fed is watching, because it's a sign of increasing inflation.

This rising differential may be one reason why the bonds are looking toppy. The toppy-appearing dollar is another reason for "nervous" bonds. Nevertheless, I believe the bond strength that we have seen so far this year has to do with the bond market's assessment of 2001. I believe the bonds are looking at a slowing economy in 2001, if not a recession.

Meanwhile, the rally in the stock market has been very selective. The A-D ratio (see page 2 chart) has been extremely sluggish, and we have not seen the kind of breadth surge that signalled so many powerful advances. As this is written, the PTI, having pushed above its moving average, has backed off and is sitting exactly on its moving average.

The PTI is holding its "forecast" in abeyance. We should too.

NOTE: For subscribers who are not on the website, I want to remind you that I'm writing a market report (plus my own thoughts and observations) six times a week, Monday through Saturday (Sunday I rest).

I don't know whether any other advisory service offers this, but you really should avail yourself of it if at all possible.

NEXT MAILING: November 29, 2000